

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

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Date:

October 30, 2014

Legend

Trust =

Trustor =

Trust Company =

Foundation =

X =

Y =

Act =

State =

Dear :

This is in response to a letter dated May 20, 2014, submitted by your authorized representative, requesting rulings under §§ 671, 674(a), 675(2), 677(a), and 2511 of the Internal Revenue Code.

The information submitted states that Trustor proposes to create an irrevocable trust ("Trust") for the benefit of herself and her issue. Trust will be created and governed by Act and the general laws of State. During the Trustor's lifetime, the Distribution Adviser may direct the Trustee (who is also an Independent Trustee) to distribute so much of the net income and/or principal to Trustor as Distribution Adviser deems appropriate in its sole discretion. During Trustor's lifetime, the Distribution Adviser may direct the Trustee (who is also an Independent Trustee) to distribute so much of the net income and/or principal to any one or more of the Trustor's issue then living as the Distribution Adviser deems appropriate in its sole discretion, but only upon obtaining Trustor's written consent ("Trustor's Consent Power"). Trustor shall exercise this power in a non-fiduciary capacity and in her sole discretion. Distributions may be made equally or unequally and to or for the benefit of any one or more of the beneficiaries to the exclusion of others. No such distribution shall be deemed to be an advance. If during Trustor's lifetime, no issue of Trustor are then living, but issue of Trustor's father are then living, the issue of Trustor's father shall be substituted for the issue of Trustor for purposes of distributions allowed during Trustor's lifetime. Any net income not distributed by Trustee will be accumulated and added to principal.

With the written consent of Trust Protector, Trustor may appoint during her lifetime ("Trustor's Lifetime Limited Power of Appointment") or in her last will and testament ("Trustor's Testamentary Limited Power of Appointment") any part of the accumulated net income and principal to any one or more of Foundation and the issue of Trustor's father (but not to Trustor, Trustor's creditors, Trustor's estate, and/or the creditors of Trustor's estate).

Upon Trustor's death, the accumulated and unappointed net income and principal shall be divided into as many equal shares as there are then living children of Trustor and then deceased children of Trustor who have issue surviving Trustor. Each such share shall be distributed to a separate family trust for the benefit of (i) each then living child of Trustor and his or her issue, and (ii) the issue of each then deceased child of Trustor. If all of Trustor's issue predecease Trustor, the accumulated and unappointed net income and principal shall be divided into as many equal shares as there are then living children of Trustor's father and deceased children of Trustor's father who have issue surviving Trustor, and each such share shall be distributed to a separate family trust for the benefit of (i) each then living child of Trustor's father and his or her issue, and (ii) the issue of each then deceased child of Trustor's father ("Alternative Mechanism"). If no issue of Trustor's father survive Trustor, the accumulated and unappointed net income and principal shall be distributed to Foundation.

The Distribution Adviser may direct Trustee (who is also an Independent Trustee) to distribute so much of the net income and/or principal of each family trust to any one or more of the beneficiaries as Distribution Adviser deems appropriate in its sole discretion. Each family trust shall terminate upon the earlier of (i) the expiration of any applicable rule against perpetuities, and (ii) the death of the last to die of the beneficiaries of that family trust. If a family trust terminates pursuant to (i), the accumulated net income and principal shall be distributed, in equal shares, *per stirpes*, to the then living beneficiaries of that family trust. If a family trust terminates pursuant to (ii), the accumulated net income and principal shall be distributed, in equal shares, to the other family trusts, and in default thereof, pursuant to the Alternative Mechanism, and in further default thereof, to the Foundation.

During Trustor's lifetime, Trustor may at any time and from time to time borrow any part of the accumulated net income and principal of the Trust ("Borrowing Power"). If the Trustor does so, Trustee (who is also an Independent Trustee) shall determine the rate of interest to be charged, which rate shall not be less than a reasonable market rate of interest at the time the loan is made, and shall determine whether or not the loan should be secured. Trustor may release this Borrowing Power, in whole or in part. Trustee (who is also an Independent Trustee) may also make loans (with adequate collateral and interest) to any person.

In the event no Distribution Adviser is serving, Trustee (who is also an Independent Trustee) shall hold and exercise full power to make discretionary distributions of net income and principal of any trust (pursuant to the same standards as were applied to the Distribution Adviser).

The initial Distribution Adviser is X. It is represented that the Distribution Advisor is not related or subordinate to Trustor within the meaning of § 672(c). In addition, any successor Distribution Adviser cannot be related or subordinate to the Trustor, within the meaning of § 672(c). The initial Trustee (who is also an Independent Trustee) is Trust Company. It is represented that Trust Company is an Independent Trustee, as defined below. Any successor Independent Trustee may not be related or subordinate to any beneficiary, within the meaning of § 672(c). The initial Trust Protector is Y. The successor Trust Protector cannot be related or subordinate to the Trustor, within the meaning of § 672(c) of the Code. The Independent Trustee, Distribution Advisor and Trust Protector of Trust or any family trust must (i) have no interest, vested or contingent, direct or indirect, in the trust estate of such trust, (ii) not be benefited by the exercise or nonexercise of any power, authority or discretion given exclusively to or vested exclusively in the Independent Trustee, Distribution Adviser, or Trust Protector, respectively, by the provisions of the trust's agreement or by law, and (ii) alone possess and exercise each such power, authority and discretion without causing income, accumulated income or principal of the trust fund of such trust to be attributable to any beneficiary (excluding the Trustor) of such trust for income, gift tax or estate tax purposes under the United States internal revenue laws in force and effect at such time

prior to the time such income, accumulated income or principal is distributed to or for the account of, or used or expended for the benefit of, such beneficiary.

## LAW AND ANALYSIS

### Ruling 1

Section 671 provides that where it is specified in subpart E of Part I of subchapter J that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under chapter 1 in computing the income or credits against tax of an individual.

Section 672(a) provides that the term “adverse party” means any person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or nonexercise of the power which he possesses respecting the trust. A person having a general power of appointment over the trust property shall be deemed to have a beneficial interest in the trust.

Section 672(b) provides that the term “nonadverse party” means any person who is not an adverse party.

Section 673 through 678 specify the circumstances under which the grantor or a person other than the grantor is treated as the owner of a portion of a trust.

Section 674(a) provides, in general, that the grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

Section 674(b)(3) provides that § 674(a) shall not apply to a power exercisable only by will, other than a power in the grantor to appoint by will the income of the trust where the income is accumulated for such disposition by the grantor or may be so accumulated in the discretion of the grantor or a nonadverse party or both, without the approval or consent of any adverse party.

Section 1.674(a)-1 of the Income Tax Regulations provides that § 674(a) may apply, whether a power held by the grantor and/or a nonadverse party is a fiduciary power, a power of appointment, or any other power.

Section 674(b)(5) provides that § 674(a) shall not apply to a power to distribute corpus either (A) to or for a beneficiary or beneficiaries or to or for a class of

beneficiaries (whether or not income beneficiaries) provided that the power is limited by a reasonably definite standard which is set forth in the trust instrument; or (B) to or for any current income beneficiary, provided that the distribution of corpus must be chargeable against the proportionate share of corpus held in trust for the payment of income to the beneficiary as if the corpus constituted a separate trust.

Section 1.674(b)-1(b)(5)(i) provides that if the trust instrument provides that the determination of the trustee shall be conclusive with respect to the exercise or nonexercise of a power, the power is not limited by a reasonably definite standard.

Section 674(b)(6) provides that § 674(a) shall not apply to a power to distribute or apply income to or for any current beneficiary or to accumulate the income for him, provided that any accumulated income must ultimately be payable (A) to the beneficiary from whom the distribution or application is withheld, to his estate, or to his appointees (or persons named as alternate takers in default of appointment) provided that such beneficiary possesses a power of appointment which does not exclude from the class of possible appointees any person other than the beneficiary, his estate, his creditors, or the creditors of his estate, or (B) on termination of the trust, or in conjunction with a distribution of corpus which is augmented by such accumulated income, to the current income beneficiaries in shares which have been irrevocably specified in the trust instrument.

Section 1.674(b)-1(b)(6)(c) provides that § 674(b)(6) is not applicable if the power is in substance one to shift ordinary income from one beneficiary to another.

Section 674(c) provides that § 674(a) shall not apply to a power exercisable (without the approval or consent of any other person) by a trustee or trustees, none of whom is the grantor, and no more than half of whom are related or subordinate parties who are subservient to the wishes of the grantor (1) to distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries, or (2) to pay out corpus to or for a beneficiary or beneficiaries or to or for a class of beneficiaries (whether or not income beneficiaries).

Section 674(d) provides that § 674(a) shall not apply to a power solely exercisable (without the approval or consent of any other person) by a trustee or trustees, none of whom is the grantor or spouse living with the grantor, to distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries, whether or not the conditions of § 674(b)(6) or (7) are satisfied, if such power is limited by a reasonably definite external standard which is set forth in the trust instrument.

Section 675(2) provides that the grantor shall be treated as the owner of any portion of a trust in respect of which a power exercisable by the grantor or a nonadverse party, or both, enables the grantor to borrow the corpus or income, directly or indirectly,

without adequate interest or without adequate security except where the trustee (other than the grantor) is authorized under a general lending power to make loans to any person without regard to interest or security.

Section 1.675-1(b)(2) provides that § 675(2) shall not apply where a trustee (other than the grantor acting alone) is authorized under a general lending power to make loans to any person without regard to interest or security.

Section 677 provides that the grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under § 674, whose income without the approval or consent of an adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be (1) distributed to the grantor or the grantor's spouse; (2) held or accumulated for future distribution to the grantor or the grantor's spouse; or (3) applied to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse.

Based solely on the facts and representations submitted, we conclude that Trust will be treated as owned by Trustor under §§ 671, 674(a), 675(2), and 677(a).

## Ruling 2

Section 2501(a)(1) provides for the imposition of a gift tax for each calendar year on the transfer of property by gift. Section 2511(a) provides that the gift tax applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 25.2511-2(b) of the Gift Tax Regulations provides that a gift is complete as to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave the donor no power to change its disposition, whether for the donor's own benefit or for the benefit of another. But if upon a transfer of property (whether in trust or otherwise) the donor reserves any power over its disposition, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the facts in the particular case. Accordingly, in every case of a transfer of property subject to a reserved power, the terms of the power must be examined and its scope determined. For example, if a donor transfers property to another in trust to pay the income to the donor or accumulate it in the discretion of the trustee, and the donor retains a testamentary power to appoint the remainder among the donor's descendants, no portion of the transfer is a completed gift. However, if the donor had not retained a testamentary power of appointment, but instead provided that the remainder should go to X or his heirs, the entire transfer would be a completed gift.

Section 25.2511-2(c) provides that a gift is incomplete in every instance in which a donor reserves the power to revest the beneficial title in himself or herself. A gift is also incomplete if and to the extent that a reserved power gives the donor the power to name

new beneficiaries or to change the interests of the beneficiaries as between themselves unless the power is a fiduciary power limited by a fixed or ascertainable standard.

Section 25.2511-2(e) provides that a donor is considered as himself having a power if it is exercisable by the donor in conjunction with any person not having a substantial adverse interest in the disposition of the transferred property or the income therefrom. A trustee, as such, is not a person having an adverse interest in the disposition of the trust property or its income.

Section 25.2511-2(f) provides that the relinquishment or termination of the power to change the beneficiaries of transferred property, occurring otherwise than by the death of the donor, is regarded as the event which completes the gift and causes the gift tax to apply.

Section 25.2511-2(g) provides that if a donor transfers property to himself as trustee (or to himself and some other person, not possessing a substantial adverse interest, as trustees), and retains no beneficial interest in the trust property and no power over it except fiduciary powers, the exercise or nonexercise of which is limited by a fixed or ascertainable standard, to change the beneficiaries of the transferred property, the donor has made a completed gift and the entire value of the transferred property is subject to the gift tax.

Section 25.2511-2(e) does not define “substantial adverse interest.” Section 25.2514-3(b)(2) provides, in part, that a taker in default of appointment under a power has an interest that is adverse to an exercise of the power. Further, a coholder of the power has no adverse interest merely because of his joint possession of the power nor merely because he is a permissible appointee under a power. However, a coholder of a power is considered as having an adverse interest where he may possess the power after the possessor’s death and may exercise it at that time in favor of himself, his estate, his creditors, or the creditors of his estate.

In *Estate of Sanford v. Commissioner*, 308 U.S. 39 (1939), the taxpayer created a trust for the benefit of named beneficiaries and reserved the power to revoke the trust in whole or in part, and to designate new beneficiaries other than himself. Six years later, in 1919, the taxpayer relinquished the power to revoke the trust, but retained the right to change the beneficiaries. In 1924, the taxpayer relinquished the right to change the beneficiaries. The Court stated that the taxpayer’s gift is not complete, for purposes of the gift tax, when the donor has reserved the power to determine those others who would ultimately receive the property. Accordingly, the Court held that the taxpayer’s gift was complete in 1924, when he relinquished his right to change the beneficiaries of the trust. A grantor’s retention of a power to change the beneficial interests in a trust causes the transfer to the trust to be incomplete for gift tax purposes, even though the power may be defeated by the actions of third parties. *Goldstein v. Commissioner*, 37

T.C. 897 (1962). See also *Estate of Goelet v. Commissioner*, 51 T.C. 352 (1968).

In this case, Trustor retained the Trustor's Consent Power over the income and principal of Trust. Under § 25.2511-2(e), a donor is considered as himself having a power if it is exercisable by him in conjunction with any person not having a substantial adverse interest in the disposition of the transferred property or the income therefrom. The Distribution Adviser may not have any beneficial interest in Trust or in any trust created under Trust, and the Distribution Adviser is not a taker in default for purposes of § 25.2514-3(b)(2). Therefore, the Distribution Adviser has no substantial adverse interest in the disposition of the assets of Trust. The Distribution Adviser is merely a coholder of the Trustor's Consent Power. Trust provides that, in the event no Distribution Adviser is serving, Trustee (who is also an Independent Trustee) shall hold and exercise full power to make discretionary distributions of net income and principal of any trust (pursuant to the same standards as were applied to the Distribution Adviser). Under § 25.2511-2(e), a trustee, as such, is not a person having an adverse interest in the disposition of the trust property or its income. Further, Trustee (who is also an Independent Trustee) has no beneficial interest in Trust and is not a taker in default for purposes of § 25.2514-3(b)(2). Accordingly, Trustee (who is also an Independent Trustee) has no substantial adverse interest in Trust. Therefore, Trustor is considered as possessing the power to distribute income and principal to his issue because he retained the Trustor's Consent Power. The retention of this power causes the transfer of property to Trust to be wholly incomplete for federal gift tax purposes.

Trustor also retained a Lifetime Limited Power of Appointment to appoint income and principal to the issue of Trustor's father or Foundation. Trustor's Lifetime Limited Power of Appointment can only be exercised in conjunction with the Trust Protector. Under §§ 25.2511-2(e) and 25.2514-3(b)(2), Trustor is considered to solely possess the power to exercise Trustor's Lifetime Limited Power of Appointment because the Trust Protector (who is merely a coholder of Trustor's Lifetime Limited Power of Appointment) has no substantial adverse interest in the disposition of the assets transferred by the Trustor to Trust because (i) the Trust Protector may not have any beneficial interest in any trust (whether before or after the Trustor's death), (ii) the Trust Protector is not a permissible appointee of the Trustor's Lifetime Limited Power of Appointment, and (iii) the Trust Protector is not a taker in default of the exercise of the Trustor's Lifetime Limited Power of Appointment.

Under § 25.2511-2(c), a gift is incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries. In this case, Trustor's Lifetime Limited Power of Appointment gives Trustor the power to change the interests of the beneficiaries. Accordingly, the retention of Trustor's Lifetime Limited Power of Appointment causes the transfer of property to Trust to be wholly incomplete for federal gift tax purposes. See *Sanford v. Commissioner*.



Finally, Trustor retained the Testamentary Limited Power of Appointment to appoint Trust property to issue of Trustor's father or Foundation, other than to Trustor's estate, Trustor's creditors, or the creditors of Trustor's estate. Under § 25.2511-2(b) the retention of a testamentary power to appoint the remainder of a trust is considered a retention of dominion and control over the remainder. Accordingly, the retention of this power causes the transfer of property to Trust to be incomplete with respect to Trust remainder for federal gift tax purposes.

Trustor retains dominion and control over the income and principal of Trust until the Distribution Advisor (or Trustee (who is also an Independent Trustee) if there is no Distribution Advisor) exercises his distribution power. Trustor's Powers over the income and principal are presently exercisable and not subject to a condition precedent. Therefore, consistent with *Goldstein v. Commissioner* and *Goelet v. Commissioner*, even if third party actions (i.e., distributions by the Distribution Adviser and/or the Trustee (who is also an Independent Trustee) to the Trustor) may defeat the Trustor's ability to change beneficial interests, the transfer of assets by the Trustor to Trust is wholly incomplete for gift tax purposes.

Accordingly, based on the facts submitted and the representations made, we conclude that the contribution of property to Trust by Trustor is not a completed gift subject to federal gift tax. Any distribution from Trust to Trustor is merely a return of Trustor's property. Further, we conclude that any distribution of income or principal by the Distribution Adviser from Trust to any beneficiary of Trust, other than Trustor, is a completed gift by Trustor at the time of distribution. Similarly, an exercise of Trustor's Lifetime Limited Power of Appointment in favor of a person, other than Trustor, is a completed gift of the appointed property. Finally, upon Trustor's death, the fair market value of the property in Trust is includible in Trustor's gross estate for federal estate tax purposes.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to a Power of Attorney on file, a copy of this letter is being sent to your authorized representative.

Sincerely,

Bradford R. Poston  
Senior Counsel, Branch 3  
Office of Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2):

Copy of this letter

Copy for Section 6110 purposes